Australia is all in favour of free trade unless you are trying to obtain a tariff concession order

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In a world dominated by headlines proclaiming trade wars and increasing US and Chinese tariffs, Australia is seen as a shining example of the benefits of free trade. It is true that when it comes to negotiating free trade agreements, Australia does remove as many barriers as it can. However, there is an increasing trend of making some tariff concessions harder to obtain. In particular, tariff concession orders (TCO) are becoming increasingly difficult to obtain or use with confidence.

Why TCOs are a good thing

Customs duties are not meant to be a revenue raising tax. Rather, the purpose of the tax is to provide protection to the Australian industry that competes with imports. You could spend a long time debating the merits of this approach, however, one thing economists and unions can agree on is that if there is no local industry to protect, there is no point in imposing a protectionist tax. Given that local manufacturers use imported goods, it would make no sense to tax those imports where there was no protectionist benefit.

This is where TCOs come in. An importer can seek the making of a TCO for particular goods with the effect that the import of those goods will be duty free. Before a TCO will be made the applicant must show that there are no substitutable goods made in Australian in the ordinary course of business.

The TCO will have wording that describes the goods it covers and the TCO will be keyed to a particular tariff heading.

If the TCO is made, any importer can use the TCO provided the following three requirements are met:

- the goods are entered for home consumption (imported) after the effective date of TCO;
- the TCO is keyed to the same tariff classification as the imported goods; and
- the goods fit within the terms of the TCO.

All of the above sounds reasonable. However, the past 5 years there has been a dramatic increase in the difficulty in obtaining and using TCOs. These difficulties could largely be cured by legislative intervention. However, it seems that the Government is happy to make it hard to reduce customs duty even where there is no local industry to protect. The clearest example of this is that it is not possible to obtain a TCO for passenger motor vehicles. This is a hangover from the days where passenger motor vehicles were produced in Australia. The local industry has gone, but the restrictions on obtaining TCOs remain.

Obtaining a TCO

Even submitting the application form is becoming harder

When applying for a TCO an applicant has to complete the prescribed form. At the time of applying for the TCO the applicant must demonstrate that all reasonable inquiries have been made to identify the extent of the Australian industry. This at least requires online searches and then contacting the local industry in writing to seek its views on the proposed TCO.

In May this year the Department of Homes Affairs (DHA) released a notice making clear that TCO applications are not to be lodged knowing that there is an Australian industry in the hope that the potential producer will not object.

The DHA has made clear that it will strictly enforce the requirement that reasonable inquires be made. If the DHA does not believe that reasonable inquiries have been made it can reject the application. If it considered that false information was deliberately provided, it could consider seeking penalties.

It is important to remember that even if the TCO applicant is the local industry, it must disclose its own potential manufacture of substitutable goods. A local manufacturer is not permitted to waive this requirement simply because it wants the TCO to be made.

What are substitutable goods

The starting point is to forget about any idea of competition or commercial realities. Substitutable goods are any goods that can be put to a use that corresponds with a use of the imported goods. In applying this test, the courts only require the corresponding use to be a reasonable one and exclude notices of price, quality and how the use is performed. This means that local goods can be deemed substitutable even in circumstances where it is very unrealistic that the imported and local goods would compete.

Driverless trains and driver operated trains are substitutable

In a recent decision[1], the Administrative Appeals Tribunal (AAT) was asked to review a decision by Comptroller-General of Customs to not make a TCO sought by Alstom (a train importer) that covered certain driverless trains. If made, a TCO would reduce the duty payable on the Indian made driverless trains from 5% to 0%.

Customs did not make the TCO as it was satisfied that EDI Downer manufactured driver operated passenger trains in Australia that were substitutable for the proposed imported driverless trains.

Alstom argued that the use of the TCO

[1] Alstom Transport Australia Pty Ltd and Comptroller-General of Customs [2019] AATA 1308

goods should be considered narrowly to be the transport of passengers on a driverless metropolitan train line system and that no trains made in Australia could be put to this use. Customs argued that the use of the imported goods was wider, being the transport of passengers by train. Whether the train was manned or driverless did not alter this use, but rather looked to how the use was performed.

Essentially, the AAT had to determine the degree of specificity with which to identify "use".

The AAT referred to past case law and dismissed considerations of how a use was performed. The AAT considered the most important aspect of use to be the transport of passengers by train. Other issues were seen as selling points, rather than a description of use.

The AAT upheld the decision to not make the TCO.

In a part of the judgment that will be welcomed by Australian manufacturers, the AAT said it is not necessary to find uses that are precisely applicable to both the local goods and the imported goods. Rather, the uses need merely "correspond". While it wasn't definitively ruled on, it was suggested that even if the use was identified narrowly as "a driverless train", this use corresponded to the use of the locally made goods, being manned trains. Essentially, the ATT is saying that it doesn't matter if the locally made goods cannot be put to the same use as the imported goods, provided the uses "correspond". The Tribunal did not elaborate on when uses that do not overlap, nevertheless "correspond". Often the term means something less than identical, but rather "similar" or "closely matches". Arguably, any vehicle used for public transport has a corresponding use to driver operated trains.

The decision may be appealed. If it is not, it should be expected that it will be rare that a TCO will be made if there is any opposition from an Australian manufacturer. It leads to the question of whether this was a good outcome for Australia. A decision had been made to move Sydney's train system to a driverless one. The driverless trains could not be sourced from Australian manufacturers. Despite this, customs duties will be imposed to protect the Australian manufacturer. Sydney commuters will pay the customs duty and the Australian industry is no better off. As revenue raising tool the customs duty works, but it performed no role as a protectionist tax.

The lesson for importers is that the bar has been set low in terms of establishing that locally produced goods are substitutable. Do not assume a TCO will be made simply because similar goods are not made in Australia. Seek advice from a trade specialist as to what the DHA is likely to consider substitutable. Whether or not the 5% duty applies will probably not be a deal breaker, but it is important to know the import costs in making costing and supply chain decisions.

Using TCOs

Once made, using a TCO is not as simple as it seems. A series of cases have established that the imported good must fit precisely within the terms of the TCO. The import must meet all of requirements of the TCO, but also do not more than that. For example, a TCO that described hoses was held not to apply to an importation of hoses and hose fittings. The problem most often arises when an importer seeks to take advantage of a TCO they did not apply for and the terms of the TCO do not precisely fit their goods.

Another issues that arises with some regularity is whether the TCO when made was classified to the correct tariff classification. An imported good must be classified to the same tariff classification to which the TCO is keyed. There may be no doubt that the good is precisely described in the TCO wording and that the TCO was intended to cover that exact good. However, it may be realised, often by an ABF auditor, that the TCO was in fact keyed to the wrong tariff classification.

When this issue is identified the ABF will insist that the goods be classified to the correct heading (as they legally must), including past imports. However, the TCO intended to be applied to those goods is not keyed to that new classification. Common sense would dictate that the TCO be moved to the new tariff classification at the same time. The problem is that the ABF will rarely backdate the movement of the TCO. While the past imports will be moved to the correct classification, the TCO will not be deemed to be keyed to that classification at the time of the past imports.

There are two solutions to this:

1. when a TCO is made the DHA should at the same time provide a binding tariff advice ruling for the goods the subject of the application. DHA has published a notice in May 2019 stating that it will not do this as it is an unnecessary duplication of effort. This seems illogical given that the DHA has to classify the goods to process the TCO application. Rather than duplication of effort, it is the same effort producing two outcomes – processing a TCO application and providing a tariff advice ruling. It is a case of double the output from the same level of effort. Further, the existence of a tariff advice would avoid inefficient audit activity in future years resulting from DHA changing its position of tariff classification;

2. if there is a change in classification, backdate that change to the time the TCO was made. This is possible under the legislation. However, it is not the common practice of DHA. One view is that backdating the classification of the TCO is unfair on those importers that used the TCO in good faith. However, the company being audited is being forced to change the classification of goods and not given the option to use the TCO. Why should that particular importer receive an adverse outcome to protect other importers who are equally guilty of incorrectly classifying the goods? For a fair outcome, either all uses of the TCO need to be audited or the change in classification of the TCO be backdated allowing all importers to correctly classify the goods and use the TCO.

Given DHA will not give a tariff advice at the time of applying for a TCO, we suggest applying for a tariff advice before applying for a TCO or alternatively, wait a short period of time and apply for a tariff advice once the TCO is made. Once the tariff advice is in place, the importer can use the TCO with confidence that at least the goods and the TCO have the same tariff classification

The future

Naturally TCOs only have a role to play where customs duty would otherwise be payable on the goods. With the rise in the use of free trade agreements, there will be less reason to use TCOs. Further, the Government is taking steps to make FTAs easier to use. Because of falling demand for TCOs it is unlikely that there will be a strong drive to improve the system. Rather, in the short to medium term it can be expected that obtaining and using TCOs will become more difficult and align with the growing protectionist trend.

However, the benefit of TCOs is that the importer contains all the information to determine whether a TCO applies. This should be contrasted with FTAs where the importer is largely relying on unverified claims by the exporter. There is certain to be major FTA compliance issues in the future. At this time you may see importers flock back to using TCOs. Unfortunately, those importers that stop using FTAs due to compliance risks will find a TCO system that is almost unworkable.

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